



COUNCIL AGENDA: 06-20-06

ITEM: 3.5

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Scott P. Johnson
Larry Lisenbee

**SUBJECT: DOLCE HAYES MANSION:
APPROPRIATION INCREASE**

DATE: June 6, 2006

Approved

Date

6-12-06

Council District: CITY-WIDE

RECOMMENDATION

It is recommended that the City Council adopt the following Appropriation Ordinance and Funding Sources Resolution amendments:

1. Establish a Transfer in the Hayes Mansion Phase III Fund to the Community Facilities Revenue Fund for \$350,000
2. Decrease the Ending Fund Balance in the Hayes Mansion Phase III Fund by \$350,000
3. Increase the Transfer-In in the Community Facilities Revenue Fund by \$800,000
4. Increase the Line of Credit in the Community Facilities Revenue Fund by \$800,000
5. Increase the Transfer to the Community Facilities Revenue Fund from the General Fund by \$450,000
6. Decrease the Workers' Compensation Claims appropriation by \$450,000

OUTCOME

Adoption of the amendments to the appropriation ordinance and funding sources resolution will allow for continued funding of Dolce Hayes Mansion operations through June 30, 2006. The decrease in the Worker's Compensation Claims appropriation, which is available due to anticipated current year General Fund savings in claim payments.

BACKGROUND

The Dolce Hayes Mansion is operated on behalf of the City by Dolce International/San Jose, Inc. (Dolce) under the terms of a management agreement with the City for a ten-year term through June 30, 2014, with renewal options. Dolce operates the property within the terms of annual operating and capital budgets approved by the City. Based on the 2005-2006 operating budget, cash requirements ("City subsidy") for the year was forecast to be \$1.95 million. The City subsidy of \$1.95 million was to be funded by:

- City Appropriation from the General Fund in the amount of \$1.6 million.
- Estimated Hayes taxable improvement bond proceeds available in Fund 434 totaling \$350,000.

In addition, based on the projections at the time Dolce developed the budget, they were strongly encouraged to cut the budget by either reducing costs or generating additional revenue to fill the \$350,000 gap.

However, as recently brought to the Council's attention in the February 2006 Monthly Financial Report (MFR), there is a need to increase the FY 2005-2006 operating subsidy. The discussion below provides an update on Dolce Hayes Mansion operating results for FY 2005-2006 and the required additional City subsidy.

ANALYSIS

Year-to-Date Financial Status Report

Dolce has continued to make positive strides in building revenue and controlling expenses. Total revenue for FY 2005-2006 is forecast to be approximately \$13.6 million or an increase of \$3.1 million (30%) over prior year revenue. Gross operating profit, which is a measure of how effectively Dolce is managing the property (prior to factoring in fixed expenses, debt service and other City expenses) is forecast to be \$650,000 in FY 2005-2006, representing an increase of \$1.1 million (244%) over prior year gross operating loss of \$450,000. Net loss (before depreciation) for FY 2005-2006 is forecast to be \$2.7 million, or \$150,000 worse than prior year net loss, due to increased debt service levels in FY 2005-2006 from rising interest rates. The table on the following page compares the current year forecast to the prior year actual profit and loss statement:

Dolce Hayes Mansion
FY 2005-2006 Forecast vs. FY 2004-2005 Actual
As of April 30, 2006

	Forecast FY 2005-06	Actual FY 2004-05	Difference
Total Revenue	\$13,550,000	\$10,500,000	\$3,050,000
Less:			
Direct Expenses	(7,800,000)	(6,450,000)	(\$1,350,000)
Indirect Expenses	(5,100,000)	(4,500,000)	(\$600,000)
Gross Operating Profit	650,000	(450,000)	\$1,100,000
Fixed Expenses	(200,000)	(150,000)	(\$50,000)
Net Operating Income	450,000	(600,000)	\$1,050,000
Debt Service, City Expenses	(3,150,000)	(1,950,000)	(\$1,200,000)
Net Income (Loss)	(2,700,000)	(2,550,000)	(\$150,000)

Proposed Budget Actions

As of April 30, 2006, the General Fund appropriation of \$1.6 million has been funded to the Dolce Hayes Mansion. As noted in the background section of this report, a City budget action is necessary to appropriate the \$350,000 in Hayes taxable improvement bond proceeds that was anticipated during the development of the FY 2005-2006 Dolce Hayes Mansion budget.

Additionally, as described below, the FY 2005-2006 annual operating City subsidy for the Dolce Hayes Mansion needs to be revised to \$2.4 million (an increase of \$450,000) over the anticipated City subsidy of \$1.95 million.

The table on the following page reflects the FY 2005-2006 profit and loss forecast for the Dolce Hayes Mansion as of April 30, 2006. As of the latest forecast, annual revenue is forecast to be approximately \$50,000 above current year budgeted revenue, resulting in a budgetary funding gap (net of debt service) of \$300,000. In addition, debt service expenses have increased by approximately \$150,000 due to higher than budgeted loan interest payments. Therefore, the anticipated additional subsidy of \$450,000 is necessary from the General Fund. The General Fund subsidy will be funded from savings in the City's Workers' Compensation Claims appropriation. The likely need for the additional subsidy was initially brought to the Council's attention in the MFR for February 2006 prepared by the City Manager's Budget Office and the Finance Department.

Dolce Hayes Mansion FY 2005-2006 Budget vs. Forecast

As of April 30, 2006

	Budget	Forecast	Difference
Total Revenue	\$13,500,000	\$13,550,000	\$50,000
Less:			
Direct Expenses	(7,800,000)	(7,800,000)	0
Indirect Expenses	(5,100,000)	(5,100,000)	0
Gross Operating Profit	600,000	650,000	50,000
Fixed Expenses	(200,000)	(200,000)	0
Net Operating Income	400,000	450,000	50,000
Debt Service, City Expenses	(3,000,000)	(3,150,000)	(150,000)
Net Income (Loss)	(2,600,000)	(2,700,000)	(100,000)
Comerica Loan Principal Payments	(500,000)	(500,000)	0
Capital Reserve - 4% of Revenue	(550,000)	(550,000)	0
Draws on Comerica Line of Credit	1,350,000	1,350,000	0
City General Fund Subsidy	1,600,000	1,600,000	0
Hayes Improvement Bond Proceeds	350,000	350,000	0
			0
Funding Shortfall	(\$350,000)	(\$450,000)	(\$100,000)

Council Referral – Reduction of General Fund Debt

Staff has been discussing with Comerica Bank and the City's Hayes Mansion asset management consultant (Horwath Hospitality & Leisure) to identify potential options available to reduce the level of debt encumbering the Dolce Hayes Mansion as well as reliance on General Fund subsidies. Staff is exploring various options, including extending the term and increasing the amount of the current \$2 million term loan with Comerica Bank to pay down the \$5 million line of credit; thereby making these funds available to be used to fund operations. In addition, discussions, which need to be explored further, include interest rate swaps and private equity contributions. Staff will provide updates to Council if these ideas materialize.

ALTERNATIVES

Not applicable.

PUBLIC OUTREACH

Not applicable.

Honorable Mayor and City Council

Subject: Dolce Hayes Mansion: Appropriation Increase

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COORDINATION

This item has been coordinated with the City Manager's Office and City Attorney's Office.

CEQA

Not a project.



LARRY LISENBEE
Budget Director



SCOTT P. JOHNSON
Director, Finance Department

For questions please contact Larry Lisenbee, the Budget Director at (408) 535-8100 or Scott P. Johnson, the Director of Finance at (408) 535-7000.